BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

SUMMARY OF ARGUMENT.

I. The findings made by the Interstate Commerce Commission with respect to the absence of value of the equity of the preferred stockholders are wholly insufficient to enable the Court to determine whether or not the plan of reorganization is fair and equitable with respect to such stockholders.

II. The Interstate Commerce Commission failed to perform its statutory duty to determine and certify the values of the Debtor's properties in accordance with Section 77 (e).

III. The plan of reorganization as approved is not fair and equitable, does not afford due recognition to the rights of the preferred stockholders, and does not conform to the requirements of the law of the land.

ARGUMENT.

Since we have presented a brief statement of the case on the petition for writ of certiorari, we shall not here repeat such statement. The issues involved in the consideration of the legality and validity of the complete elimination of the preferred stockholders are many and it is not our purpose at this time to go into them in detail. We shall simply state the outstanding reasons in our opinion why the Court should hear this case, and more detailed argument will later be made on brief and in oral argument, in the event this Court sees fit to grant our petition for a writ of certiorari.

I.

The Findings Made by the Interstate Commerce Commission With Respect to the Absence of Value of the Equity of the Preferred Stockholders Are Wholly Insufficient to Enable the Court to Determine Whether or Not the Plan of Reorganization Is Fair and Equitable With Respect to Such Stockholders.

The Interstate Commerce Commission in its report approving the plan of reorganization based its opinion that the holders of the preferred stock had no equity, entirely on its views as to the earning power of the Debtor. The Commission disagreed completely with the contentions of the Debtor and the stockholders regarding the high earning power of the railroad and refused to consider any evidence of physical value. It made no finding as to the value of the assets of the company such as was necessary in order to determine whether or not those assets fell short of the amount of the debts of the company. It should be remembered that at no time has there been a finding of insolvency of the Debtor. Further, although the decision of this Court

in the *Consolidated Rock Products Company* v. *DuBois*, 312 U. S. 510, had not been announced at the time of the report and order of the Interstate Commerce Commission approving the plan, the principles of *Northern Pacific Railroad Company* v. *Boyd*, 228 U. S. 482, and of *Case* v. *Los Angeles Lumber Products Company*, 308 U. S. 106, in which it was determined that the first principles of the Boyd case applied equally to reorganizations consummated under Section 77 and 77B of the Bankruptcy Act, had been well established. The *Consolidated Rock Products* case, *supra*, has completely settled the necessity of a trustworthy appraisal of the assets of the Debtor. Since it was upon the basis of that latter case that the Circuit Court of Appeals below reversed the District Court's approval of the plan, we feel that the preferred stockholders are as entitled as any other parties to the protection of such principles. The capitalization of prospective earnings attempted to be made by the Interstate Commerce Commission did not take into account favorable earnings factors, and both the District Court and the Circuit Court of Appeals completely refused to recognize for its true worth the changed earning position which has been so markedly reflected in the earnings for the past two years.

Under the doctrine of the case of *Atchison, Topeka & Santa Fe Railway Company, et al.* v. *United States*, 284 U. S. 248, and *Central Kentucky Natural Gas Company* v. *Railroad Commission of Kentucky, et al.*, 290 U. S. 264, this Court should take judicial notice of economic changes such as are evidenced in the case of railroad earnings today, which earnings are a part of the record herein up to date of the filing of the record in this Court.

The Court below said that it was well satisfied that the evidence supported the finding of absence of value in the equity even though the evidence of the current earnings made since the plan was approved, were received and con-

sidered. It mentioned that there was a question of the court's power to base its decision upon 1941 statistics, which we feel has been settled by this Court in the two cases just mentioned. The three paragraphs in which the Circuit Court of Appeals states that there is no support for a finding of value in the preferred and common stock (Rec. 2311) reflect that Court's opinion that, although the Commission failed to make sufficient findings in accordance with the *Consolidated Rock Products Co.* case, still it could gloss over such failure so far as the equity holders were concerned. In the supplementary Per Curiam opinion issued January 12, 1942, the Court said that there had been a sufficiently specific finding as to the value of the equity, but it does not point to where this finding may be found. Certainly if the evidence might support a larger amount of securities, there would be room for some participation by the equity holders. Whatever findings were made by the Interstate Commerce Commission, they were wholly insufficient to enable the Court intelligently to pass upon the validity and legality of the treatment of the preferred and common stockholders.

II.

The Interstate Commerce Commission Failed to Perform Its Statutory Duty to Determine and Certify the Values of the Debtor's Properties in Accordance With Section 77(e).

The language of Section 77(e) provides in part:

> "If it shall be necessary to determine the value of any property for any purpose under this section, the Commission shall determine such value and certify the same to the court in its report on the plan. The value of any property used in railroad operation shall be determined on a basis which will give due consideration to the earning power of the property, past, pres-

ent, and prospective, and all other relevant facts. In determining such value only such effect shall be given to the present cost of reproduction new and less depreciation and original cost of the property, and the actual investment therein, as may be required under the law of the land, in light of its earning power and all other relevant facts."

Certainly this language is clear and unequivocal, and if it can be said that determination of value of property is ever necessary under Section 77, it must be held to be necessary in order to foreclose the stockholders of the Debtor and completely eliminate them from any participation in the plan of reorganization. Neither the Interstate Commerce Commission, the District Court, nor the Circuit Court of Appeals has discussed or considered the question of issuance of rights in the form of options or warrants to receive or subscribe for securities of the reorganized company, in order to give the stockholders participation in the event that in the future there might be some opportunity to participate in the earnings. Under the principles, first, of the *Boyd* case, second, of the *Los Angeles Lumber Co.* case, and third, of the *Consolidated Rock Products Co.* case, it is an absolute essential that a valuation be made of the Debtor's assets, which must be done in accordance with the above provisions of Section 77(e), and unless those assets are shown to have a value less than the aggregate of the debts, the stockholders can not be deprived of participation, in some form or other, in the plan of reorganization.

III.

The Plan of Reorganization as Approved Is Not Fair and Equitable, Does Not Afford Due Recognition to the Rights of the Preferred Stockholders, and Does Not Conform to the Requirements of the Law of the Land.

On July 31, 1940, the Protective Committee for Preferred Stockholders filed its objections to the plan of reorganization approved by the Interstate Commerce Commission and certified to the District Court (R. 1397). Briefly, these objections may be summarized as follows:

(1) The Commission erred in finding that the equities of the preferred stockholders have no value and that the holders of said stock should not participate in the allocation of new securities;

(2) The Commission erred in promulgating a plan of reorganization which failed to establish a valuation of all of the Debtor's assets for the purpose of determining whether or not said assets exceeded the Debtor's liabilities;

(3) The Commission erred in ignoring the fact that the value of the Debtor's properties established by the Commission under Section 19A of the Interstate Commerce Act was substantially in excess of the capitalization established by the Commission for the reorganized company;

(4) The Commission erred in its determination of earnings for a normal year for the reasons that (a) it does not appear that any consideration was given to the extensive maintenance program conducted by the Debtor out of earnings since the proceeding under Section 77 was instituted, as a result of which the true earning capacity of the Debtor has been understated; (b) calculations of future earnings have been based on the record during the most unfavorable period of the Debtor's estate as well as of industry generally; (c) no consideration has been given to the increased

earning capacity of the Debtor; (d) no consideration has been given to estimates of saving from coordinations and consolidations with other roads; (e) no consideration was given to the possibility of adjusting the increased labor costs incurred during the past decade, the entire burden of which is imposed upon the preferred and common stockholders under the Commission's plan;

(5) The Commission erred in establishing a capitalization for the reorganized company in an amount less than the invested capital in Debtor's properties;

(6) The Commission erred in establishing the effective date of the plan as January 1, 1939, rather than July 1, 1935, the nearest convenient date to the date of filing of the petition, and further erred in recommending that interest accrued since the date of filing of the petition should be allowed in full to such effective date of the plan on all issues of bonds and notes of the Debtor;

(7) The Commission erred in not having determined the value of the properties of the Debtor and in not having certified the same to the Court in its report of the plan as required by Section 77(e) of the Bankruptcy Act;

(8) The Commission erred in refusing to permit studies to be made of a plan based on the consolidation of the Debtor and the Chicago and North Western Railway Company;

(9) The Commission erred in approving a plan which is not fair and equitable, does not afford due recognition to the rights of each class of creditors and stockholders, is unfair to preferred stockholders, and does not conform to the requirements of the law of the land regarding participation of the various classes of creditors and stockholders in distribution of the securities of the new company, and is not in the public interest.

All of these objections to the plan were overruled to

the District Court and on appeal to the Circuit Court of Appeals were insisted upon both on brief and in oral argument. We deem each one of them of extreme importance and worthy of the consideration and determination by this Court. We do not wish at this time to make a detailed argument on these propositions and have therefore merely stated them, but in the event that this Court grants the petition for a writ of certiorari, they will be argued in our brief on the merits.

If the property of the preferred stockholders is to be taken completely from them as is done by the plan approved by the Commission and the District Court, and, insofar as the stockholders are concerned, approved by the Circuit Court of Appeals, it must be taken with due process of law. Certainly, the stockholders can not be said to have had such due process of law where there has been no actual finding as to value of Debtor's assets. We therefore maintain that the property of the stockholders, both preferred and common, has been taken in violation of the Fifth Amendment of the Constitution of the United States, both without due process of law and without just compensation.

In view of the fact that the reversal of the Circuit Court of Appeals below was entirely predicated upon the *Consolidated Rock Products Co.* case, *supra,* and the failure of the Interstate Commerce Commission to make the necessary "findings on issues vital to the question of values and equities as announced in said Consolidated Rock Products case" (R. 2315), it cannot be said to be either legal or equitable treatment of the stockholders to hold that insofar as they were concerned, sufficient findings were made. The Court itself said that the evidence might support a finding of a larger or a smaller amount but that the Commission was the fact-finding body so that the Court could not determine which amount should be accepted. If, as we contend, the evidence supports a larger amount of

capitalization, then certainly there is an equity for the preferred stockholders and the proceedings should be referred back to the Commission without any restrictions as to what they may or may not consider. To quote the Court on one of the pertinent holdings of the *Consolidated Rock Products Co.* case (R. 2309):

> "Findings must be made on all vital issues, controverted and uncontroverted, and must include values of properties separately considered and also of Debtor's property as a whole. Findings must cover values of liens to be surrendered and values of securities given in exchange. They should specifically cover the ultimate (not evidentiary facts) facts upon which the values are based. They must show that fixed interest charges are included and show that values are based on income-producing factors."

Conclusion.

The Preferred Stockholders Committee fully appreciates the length of time which has been consumed in these proceedings. Nevertheless the factor of time is far outweighed by the importance of complying with the provisions of Section 77, which require that a plan of reorganization conform to certain standards of legality and justice. Throughout the period of the proceedings the trustees operating the Debtor's properties have maintained it in splendid condition and the income has been so favorable as to warrant more than an expectation of a chance for the stockholders to participate, should they be allowed options or warrants under a fair plan of reorganization. We earnestly request that the issues raised by the elimination of the stockholders from such participation be scrutinized by this Court and that propositions of law be established which will enable the Commission definitely to know what standards should be followed not only in this case but in the case of all other railroad reorganiza-

tions under Section 77. For these reasons we believe the decree and opinion of the Circuit Court of Appeals below should be modified so as to provide for unhampered consideration by the Commission of new evidence and of the present evidence in the light of whatever principles may be enunciated by this Court, without any such restrictions as are suggested in the opinions of December 4, 1941, and January 12, 1942.

Respectfully submitted,

EDWARD R. JOHNSTON,
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Attorneys for H. C. Orton, et al.,
Petitioners.

(36)

IN THE

Supreme Court of the United States

October Term, 1941

No. 881 [redacted] 55
(Circuit Court of Appeals No. 7615)

In the Matter of
CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY, DEBTOR.

UNITED STATES TRUST COMPANY OF NEW YORK as Trustee of General Mortgage of Chicago, Milwaukee and St. Paul Railway Company dated May 1, 1889,
Petitioner,

et al.,

v.

GROUP OF INSTITUTIONAL INVESTORS, ETC., *et al.*,
Respondents.

Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit and Summary of Argument in Support Thereof.

GEORGE L. SHEARER,
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STEWART & SHEARER, New York, N. Y.;
Attorneys for Petitioners.

March 23, 1942.

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IN THE

Supreme Court of the United States

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Petitioner,

et al.,

v.

GROUP OF INSTITUTIONAL INVESTORS, etc., *et al.,*

Respondents.

To the Honorable the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

This petition is made by United States Trust Company of New York as trustee under the General Mortgage of the Chicago, Milwaukee and St. Paul Railway Company. Your petitioner respectfully prays that a writ of certiorari issue from this court to review the judgment or order of the

United States Circuit Court of Appeals for the Seventh Circuit, entered herein December 4, 1941, reversing the order of the District Court for the Northern District of Illinois which approved the Plan of Reorganization of the above named Debtor certified by the Interstate Commerce Commission as modified by such Commission, which order of the Circuit Court of Appeals further directed the District Court to set aside its order of approval and to remand the case to the Interstate Commerce Commission, and your petitioner prays that on such review the order of the Circuit Court of Appeals be modified as specified in this petition.

A petition for certiorari has been filed by the Group of Institutional Investors and Mutual Savings Bank Group. As we deem it important that the case be brought before this Court, we do not object to the petition of these Groups, believing as we do that the whole case should be reviewed by this court and that these issues, of grave import to the future of railway enterprise in this country, demand clear enunciation by this court.

Opinions below

This is a proceeding under Section 77 of the Bankruptcy Act for the reorganization of the Chicago, Milwaukee, St. Paul and Pacific Railroad Company. Various plans for reorganization have been submitted and hearings held before the Interstate Commerce Commission. The report and order of the Commission approving a Plan of Reorganization were made February 12, 1940 (Transcript, pp. 1258-1283; 2153-2269; reported 239 I. C. C. 485). On June 4, 1940, a supplemental report and order was issued by the Commission modifying its previous Plan and as modified the Plan was approved and certified to the District Court (1284-1317; 1319-1347; reported 240 I. C. C. 257).

Sundry objections to the Plan were filed by various parties, including your petitioner, hearings on the objections were held in the District Court through several days in September, 1940, and evidence presented to the court in addition to the record before the Commission. On October 21, 1940, the District Court handed down its opinion approving the Plan (1857-1899; reported 36 Fed. Suppl. 193), and thereafter made findings of fact and conclusions of law and its order approving the Plan November 13, 1940 (1978-1992). An appeal therefrom was taken by several of the parties, including your petitioner, to the United States Circuit Court of Appeals for the Seventh Circuit, and after hearing such appeal that court reversed the order approving the Plan and by its order of December 4, 1941, reversed the District Court order and remanded the case to that court with directions to set aside that court's order of approval and to remand the case to the Interstate Commerce Commission for the making of findings, and if necessary, the taking of additional evidence, that additional findings might be made, as indicated in the opinion of the Circuit Court of Appeals filed herein (2322).

Some time after the making of this order of reversal application was made on behalf of stockholders for a "modification of opinion" (2324-2329) and a supplemental order was thereafter made by the United States Circuit Court of Appeals January 12, 1942 (2334-2335) in which it was declared:

> "Now, to make our position entirely clear, we add this memorandum and hold that the finding of the I. C. C. as to absence of value of old common and preferred stock, is specific, definite and certain, and fully meets the rule which requires finding on values of assets.
>
> Second, we meant to hold, and do hold, that the evidence supports this finding, that there is no value to either the common or preferred stock of debtor. It follows that this branch of the case, the value of the equity of the debtor, evidenced by the common and

preferred stock, is closed, and the I. C. C. need not further investigate or make further finding on this issue unless it is convinced that changed conditions in railroad earnings warrant it. In other words, the I. C. C. has jurisdiction of the matter and may, although it is not required to do so, re-examine the evidence, or receive additional evidence, if in its judgment, justice to the parties requires it.

The motion to amend the opinion is DENIED."

Summary of Matters Involved

THE PROPERTY

Your petitioner's General Mortgage for $150,000,000 is the underlying mortgage placed in 1889 on what was then the entire system of the Chicago, Milwaukee and St. Paul Railway Company and is now the main line of that company's successor, the present Debtor. Many years after this mortgage was made the mortgagor company, the old Chicago, Milwaukee & St. Paul, caused to be built and then acquired the so-called western extension, a new railroad running from the Missouri River terminus of the old Milwaukee in Mobridge to the Pacific coast. This added enterprise is for convenience referred to as the lines west. Still later the old Milwaukee acquired substantially all the capital stock of the Chicago, Terre Haute and Southeastern Railroad Company, hereinafter referred to as the Terre Haute, and made a lease whereby it acquired the use of that road, agreeing to pay as rental therefor the interest on the road's bonds and a fixed sum of $12,000 a year for routine organization expenses, and to pay the principal of the bonds on maturity. Certain other additions had been made to the Milwaukee system since our mortgage was executed, but those above mentioned are the principal additions here involved and present certain of the most substantial and important questions involved in this litigation.

As for the lines west, the Commission specifically reported (1307):

> "We are satisfied that on any reasonable basis of allocation between the lines west and the other parts of the system, the lines west cannot be expected to earn any sum for the payment of interest."

Our underlying General Mortgage has at all times been and now is fully secured by the mortgaged property and its earnings. Of the $138,788,000 of bonds issued under our mortgage and outstanding in the hands of the public there is, including accrued interest unpaid, a total claim of $156,368,193; the remaining $11,212,000 principal of those issued are pledged with the Reconstruction Finance Corporation (2166). Partial payments have been made on account of bond interest accruing since the initiation of this proceeding (*ib.*). These bonds are secured by a first lien on the main railroad system. It is reported by the Commission (2167):

> "The properties subject to the first lien of the general mortgage included 6,044 miles of road wholly owned, lying east of the Missouri River, 11.3 miles of road jointly owned, various trackage rights, 1,030 locomotives, 24,690 freight cars, 885 passenger cars, and 2,013 units of work equipment not subject to the lien of equipment trusts, 7,000 shares of the capital stock of the Chicago Union Station Company, and certain cash. Subject to the lien of equipment obligations totalling $25,031,319, the general mortgage was also secured by a first lien on 119 locomotives, 32,441 freight cars, 79 passenger cars, and 26 units of work equipment. It appears that no equipment deficiencies have been incurred under this mortgage."

The depreciated book value merely of this equipment owned outright, and of the equity in that owned subject to equipment liens, was, under date of June 30, 1935, approximately $49,000,000 (I. C. C. Exs. 74 and 114, not printed).

For all practical purposes the Fifty-year Five per cent mortgage, referred to for convenience as the Fifty-year

Mortgage, is a first lien on the lines west and a second lien on our main line. It is at present subject to a small issue of First and Refunding Mortgage bonds, but none of these are in the hands of the public and under the Plan they are to be retired and their first lien may be disregarded. One of the fundamental facts of the situation is that the lines west, for almost the whole time since the consummation of the ill-advised enterprise of their construction, have been deficit lines. As the Commission found (1307):

> "We are satisfied that on any reasonable basis of allocation between the lines west and the other parts of the system, the lines west cannot be expected to earn any sum for the payment of interest. In years when the system earnings approach $10,000,000, some interest is apparently earned for the 50-year mortgage bonds under the present capital structure, but this reflects system operation and does not demonstrate any earning power for the western lines."

The Fifty-year Mortgage, in addition to being practically a first lien on the lines west and a second lien on our line, was a lien immediately junior to that of the First and Refunding Mortgage on certain collateral pledged under the latter. At the moment such lien is subject to the First and Refunding Mortgage, but as stated above that mortgage is to be cancelled, so that the Fifty-year Mortgage would be the next lien on such collateral. As this is to be brought about by giving the present holders of the First and Refunding Mortgage security 100 per cent of their claim in new First Mortgage fixed interest bonds, thus reducing the amount of such bonds available for allocation to the bondholders under our underlying mortgage, a question is presented as to whether or not our bondholders should be subrogated to the rights of the First and Refunding Mortgage. For our position on this question we refer to the petition for certiorari and supporting brief of the Group of General Mortgage bondholders consisting of Princeton University and others.

Terre Haute

As for the Terre Haute stock and bonds and lease, the Commission found that the present lease was burdensome and should be rejected by the trustees. The Commission's Plan, however, did not provide, as we contended that it should provide, merely for the rejection of the lease, leaving the Terre Haute interests and the reorganized road free to negotiate such traffic agreement as might be found proper in the event that the reorganized road should wish to continue the use of the Terre Haute. It engrafted on the Plan a proposed new arrangement to be offered the Terre Haute interests, with a provision that if substantially all of them did not accept such modified Plan, the lease should in that event, and in that event only, be terminated. Among the objectionable features in the present lease was the Milwaukee's assumption of the obligation of payment of principal and interest of the Terre Haute bonds, bonds exceeding in amount the $20,680,114 value of the Terre Haute properties, awarding to the holders of the securities of the dubious Terre Haute enterprise a largess far exceeding, in its liberal percentage of compensation, the attenuated recompense offered the holders of our well secured underlying bonds secured by property valued at $359,115,599 (2215).

Probable prospective earnings

For its estimate of the system's earnings before fixed charges, the "probable prospective earnings" to be used in providing for fixed charges under Sec. 77 of the Bankruptcy Act, sub. (b), the Commission used two five-year averages, one 1931-35, showing $7,852,798 and the other 1932-36 showing $7,988,191. One at 116 per cent and the other at 118 per cent coverage would give the figures used by the Commission as it points out in its report, and as the two amounts are so close and are both stated in

the report, the Commission's finding of prospective earnings is in effect the mean between the two, or $7,920,425 (2219). These figures are of course of several years ago, ending with 1936 at the latest. On any rehearing on which findings are to be made, both the court and the Commission will assuredly have to consider the figures nearer to date. The trustees' evidence at the court hearing showed net earnings before fixed charges for 1940 (the last six months being estimated) of $14,079,381 (Debtor's Ex. 6 in District Court). Current earnings are at a very much higher level than this, which itself is much higher than the available earnings in either of the five-year periods mentioned. As it stands, nothing since 1936 is reflected in the Plan.

The "Pieces East"

There are a few pieces of line integrated with the General Mortgage lines, acquired since the execution of that mortgage, which are referred to as the "pieces east." There is a controversy, left undetermined both by the Commission and by the courts below, as to whether they are covered by the after-acquired property clause of the General Mortgage and thus subject to its first lien, or on the other hand do not fall within it and are therefore subject to the first lien of the First and Refunding Mortgage and to the second lien of the Fifty-year Mortgage (2252).

Treatment of General Mortgage Bonds under the Plan

Under the Plan as modified (1317) there was to be a First Mortgage on the entire system, including not only the main railway system now subject to our underlying mortgage but also the unremunerative lines acquired many years after our mortgage was made, specifically the so-called lines west from the Missouri River to the Pacific coast. New First Mortgage bonds were to be pres-

ently issued for distribution among various classes of security-holders to the amount of $53,923,171, in addition to which the new company was to assume the obligations of the $21,929,000 of Terre Haute bonds. The holders of the present General Mortgage bonds were to receive $39,092,049 of new First Mortgage bonds, being 25 per cent in par value of their secured claim, an amount based on a capitalization of probable minimum future earnings which excludes $2,500,000 per year of such earnings from capitalization and gives us no fixed-interest or First Mortgage bonds based on that portion of the earnings, but diverts that portion to an Additions and Betterments fund for future *capital* requirements year by year. The Plan also provided for new contingent-interest second mortgage bonds of two series, of which the present General Mortgage bondholders were to have Series A bonds to the extent of 35 per cent of their secured claim, or $54,728,867, and $31,273,638 of Series B bonds, this being 20 per cent of their secured claim. As between these two series the Series A bonds were to be prior in charge as to interest only. Along with the issue to us of $31,273,638 of Series B bonds, $19,084,621 of the same issue were to go to the present holders of the Fifty-year Mortgage 5 per cent bonds now secured by the lines west, on which our mortgage is not a lien and whose only lien on our mortgaged lines is admittedly a subordinate one. This would leave 20 per cent of the General Mortgage claim still to be provided for, and this was attempted to be accomplished by alloting to their holders such 20 per cent in new preferred stock. The new preferred stock thus allotted to them amounted to $31,273,638 (at $100 par), but the greater part, or $76,338,481 of the $111,347,846, of new preferred stock went to the Fifty-year Mortgage bonds. To pay the dividend on this preferred stock would require, under the present tax law, earnings of between $40,000,000 and $50,000,000 per year. The road has never, even in the pre-depression days, earned as much as $33,000,000 per

year, so that this allotment of preferred stock is hardly more than a gesture. Thus the only new First Mortgage bonds for the General Mortgage bondholders would be in the amount of 25 per cent of their secured claim, a total of $39,092,049 among the $53,923,171 to be presently allotted, or among $69,273,171 of the fixed-interest portion of the bonds if we include the $15,350,000 fixed-interest portion of the Terre Haute bonds whose obligation is to be assumed.

No provision for new evidence

As the present order stands, it is left to the discretion of the Commission whether it will take additional evidence. We should not have supposed that either an administrative or judicial inquiry, undertaken to lay the foundations of a plan of reorganization affecting among other things the rights of secured creditors running into hundreds of millions of dollars, could be carried through without enlightenment as to the present conditions and earnings of the property and in disregard of evidence of anything more recent than four years ago. The statute requires due consideration of past, present and prospective earnings.

The foregoing statement has been made as concise as is consistent with a presentation of enough of the background to make possible an intelligent understanding of the issues presented. A complete tabular summary of the Plan is shown on page 5 (wide-page insert) of the petition for certiorari presented by the Institutional Investors and Mutual Savings Bank Groups.

This is the Plan of Reorganization reported by the Commission and, with slight modification or corrections, approved by the District Court, and now apparently approved in general plan and principle by the Circuit Court

of Appeals, the reversal being for the purpose of making necessary findings and the Plan itself being in general commended. Our contention is that such a Plan does not meet the requirements imposed by law for a plan of reorganization; that it is unfair and inequitable and not in conformity with the law of the land and unlawfully deprives our bondholders of their property in violation of law and of the Fifth Amendment to the constitution of the United States. Its manifest departures from the standards imperatively laid down by Sec. 77 ignore a mandate which but recognizes and incorporates in the Bankruptcy Act certain fundamental principles required by the constitution and the law of the land. On the case being sent back for the restatement and reformulation of a plan, it is in the interest of justice, and in the public interest, that this court declare and so far as needful formulate those inherent and fundamental requirements that must inexorably be recognized and applied by the Commission. Otherwise this reorganization will be protracted beyond reasonable limits and the present errors and unjustifiable subversion of recognized principles be repeated and require probably several years for their judicial correction through the slow process of future appeals.

The "questions presented" are formulated in a later part of this petition, but to make a complete presentation of the matters involved their nature is stated in general as follows:

1. Our bonds are entitled to the protection of the established principle of absolute priority

It being shown that our mortgage is the underlying first lien on almost the whole of the remunerative portion of the Milwaukee system, under the principle of absolute priority, as declared in *Northern Pacific R. R. Co.* v. *Boyd,* (228 U. S. 482) and reaffirmed as applicable under the bankruptcy statutes in *Case* v. *Los Angeles Lumber*

Co., (308 U. S. 106) and *Consolidated Rock Products Co.* v. *Du Bois*, (312 U. S. 540), our bondholders are entitled to the preservation of their prior lien. It is recognized that in the public interest the interest charges on new mortgage bonds given in reorganization to old bondholders may as to a portion thereof sometimes be made contingent, so that bankruptcy will not be a necessary result of the road's inability to earn its entire mortgage interest, and it is recognized that in drawing the line between fixed interest and contingent interest under any new mortgage a reasonably safe leeway or coverage must be provided. Using the Commission's finding above referred to of minimum prospective earnings of $7,920,425 per year, it is contended that under Section 77 of the Bankruptcy Act it is imperatively required that after deducting from this amount a fair and reasonable portion thereof to represent coverage and whatever may be required for other fixed charges ranking ahead of us, then for our underlying mortgage, and any other secured claims on a parity with it, the Plan should capitalize the remainder of these prospective minimum earnings in the form of a first lien on the mortgaged property, so that the secured creditors should receive new first lien fixed interest securities representing the capitalization of such remaining minimum prospective earnings up to the amount of their present secured interest charge. In fixing its capitalization the Commission has made deductions to allow for a coverage of 116 per cent, as to which there is no controversy, and has made further deductions representing equipment obligations and certain other obligations in respect to leased lines. These include the Terre Haute lines. Their treatment is a subject of separate contention on our part and may for the moment be disregarded.

2. Additions and betterments fund

We have objected to the deduction made at this point by the Commission of a mandatory Additions and Betterments fund, fixed by the Commission at $2,500,000 per year. The purpose of this fund, as the name indicates, is to provide for *capital* expenditures. We contend, as a matter of law, that the prospective minimum net earnings available for fixed charges must under the principle of absolute priority be made available to our bondholders; that to divert them to capital expenditure for the benefit of the equity would be to violate our legal and constitutional rights. If in the public interest it were deemed that such expenditures must be made and that there were no source other than earnings from which to make them, then if earnings contractually available for our interest were resorted to this would in effect be a forced loan and we should be entitled to contingent interest bonds, fully cumulative, preserving our right to have such forced loan made good upon there being subsequent net earnings available therefor.

The practical effect of interposing this $2,500,000 mandatory Additions and Betterments fund among the fixed charges, where we contend it has no place, is of course to diminish to that extent the income available for interest on the new first mortgage bonds; in other words to reduce by the capitalized value of such $2,500,000 the amount of bonds available for the present holders of underlying mortgage bonds. Capitalized at the allowed rate of 4 per cent (as to which rate there is no question raised by anyone) this means that our bonds are to receive $62,500,000 less first mortgage bonds than they would receive if the Additions and Betterments fund were not injected into a place among the fixed charges; so that instead of receiving new first mortgage fixed interest bonds for approximately 66½ per cent of our bondholders' secured claim they are to have but 25 per cent thereof. This raises, of course, as we have

just pointed out, the fundamental question of law whether under the established principle of absolute priority it is permissible to withdraw from the income pledged to the underlying mortgage bondholders this large sum desired for capital Additions and Betterments; or, even assuming that in the public interest this may be done, whether if so done it may be properly treated as anything other than a forced loan from the underlying mortgage bondholders which should be repaid should further earnings supply the means. The latter object would be accomplished, so far as it may be, by giving the underlying mortgage bondholders, for an amount equal to to the fair capitalization of the portion of interest so withheld, contingent interest bonds with interest fully cumulative. Under the Plan, however, they by no means receive full cumulative contingent interest bonds for the portion of their debt not represented by new fixed interest bonds. Under the succeeding categories they are to receive 55 per cent of their debt in contingent interest bonds, but these are not fully cumulative, the accumulation being limited to three years, and for 20 per cent of their holdings they are to receive the wholly illusory distribution of new preferred stock, represented by certificates bearing it is true a figured inscription reading "$100" each but representing in fact a share in earnings which under the present tax structure would be wholly absorbed by taxation and would never reach the stockholders.

3. Dilution of our mortgage security

Thus the Plan offers our bondholders new fixed interest first mortgage bonds to the extent of but 25 per cent of the face value of their secured claim; for the next 35 per cent thereof they are to have contingent interest bonds Series A, and for 20 per cent contingent interest bonds Series B. The difference between these two series is that Series A has priority as to income; as to principal there is no pri-

ority as between the two series. But in the allotment of Series B bonds our bondholders do not have the entire issue of those bonds, as they presumptively should have to conform to the principle of absolute priority, for they share that issue with holders of the present Fifty-year Mortgage bonds, a junior issue. We recognize that in the application of the principle of absolute priority it is sometimes practically necessary that holders of present prior liens should receive new securities of an issue some of which are allotted to holders of present junior liens. This was expressly recognized in *Case* v. *Los Angeles Lumber Co.* (308 U. S. 106) and in *Consolidated Rock Products Co.* v. *Du Bois* (312 U. S. 540); but in the former case it was pointed out that such dilution or intrusion of junior lienors to share in securities allotted to prior lien creditors should represent some value contributed by them to the enterprise, and in the latter that such a dilution must be based on specific findings of values of respective property contributions, and compensation must be made for the lienor's "full bundle of rights". Nothing of the sort was shown here; the Fifty-year Mortgage district is, as we have shown by reference to the finding of the Commission, a deficit line, nor is there anywhere in the record any finding of value contributed by its mortgaged property. We therefore contend that the award to the Fifty-year Mortgage bondholders of any portion of the contingent interest bonds unlawfully dilutes our bondholders' security and gives them less than the absolute priority to which under the decisions of this court they are entitled.

4. The plan imposes on bondholders now secured by an underlying mortgage the burden of a new mortgage made by a corporation obliged by its charter to operate a deficit line, thus unlawfully impairing the earnings pledged for the payment of our interest

Under the traditional obligations of a mortgage, which in general are in principle recognized and preserved in reorganization, a mortgagee is entitled to the security of his lien, and the principle of absolute priority must be maintained. This means that normally he should have in the reorganized company a lien upon the same property, and the ultimate right to make the earnings of that property available for his debt, as that on which he holds his mortgage. Our mortgaged property was the definitely described established line of the Chicago, Milwaukee and St. Paul Railway Company; a property of high value and earning power and earning even in the depression more than enough to pay our interest. The Plan offers our bondholders the mortgage of a new corporation which is to own, and whose duty it would be to operate, in addition to the General Mortgage lines, a line of railway forming no part of our original mortgaged property and acquired many years after our mortgage was given. To force us to take the bonds of a corporation thus obliged to carry in perpetuity this old man of the sea is to decree that the payment of the annual deficit of such a new enterprise be included among the operating expenses of the railroad whose new mortgage we have to take. Such an intrusion into the income pledged for the payment of our interest would in the case of an ordinary mortgage not be tolerated by a court of equity nor might it ordinarily be lawfully imposed by the law-making body. To be sure, this is the case of a railway, but it can hardly be any supposed public interest that is invoked for the sake of "simplifying the mortgage structure" and to carry out a policy of reducing the number of railroad corporations in the country. There is nothing shown in the present record indicating that it would be

impracticable to have separate corporate organizations co-extensive with the wholly separate and distinct enterprises represented by the original Chicago, Milwaukee and St. Paul Railway and by the western lines organized and built in subsequent years. Recognition in the corporate organization of the distinct identities of two enterprises would not mean that the western lines were to be summarily cast adrift. Doubtless operation would be continued for a substantial period under a lease or operating agreement with the original company. Indeed, the Commission has not found that such operation could not be continued, nor that the existing lien of our mortgage could not be preserved without impairing our right to resort to the net income of our own mortgaged property free from liability to diversion to pay operating deficits on another line. The Commision simply suggests that such a mortgage structure would be too cumbersome, but we contend that the integrity of our mortgage lien may not be lawfully impaired in such an easy way or so summarily dismissed. Indeed, the Fifty-year Mortgage interests themselves do not question the practicability or advisability of separate organizations for the two roads. They have a second mortgage on our lines, to whose benefit they are entitled. We have no lien on their lines and it is contrary to law that such a juggling and distortion of liens be willy-nilly imposed upon us with the burden of carrying in perpetuity the operating deficit of a line not in existence or conceived of when our mortgage was given.

With the order made by the Circuit Court of Appeals so far as it reverses the order approving the Plan we have of course no disagreement, for the Plan propounded by the Commission and approved by the District Court could not, in respect to the matters immediately above presented, have been approved by the appellate court without violating the legal and constitutional protection afforded secured creditors by Section 77 of the Bankruptcy Act. But the

court's implied approval of the Plan, with its cryptic comment that "the fact situation permits of a Plan such as the Commission formulated and approved" (2312), sets on the Plan an implied approval which, we submit, is not only admittedly without the supporting premise of informed judgment but violates the fundamental principles of the law of the land carefully reiterated in the bankruptcy act itself as a precaution against confiscation such as has been attempted by this Plan.

We contend that the Court of Appeals should have definitely and explicitly sustained our contentions and granted our demand that these objectionable and illegal features be eliminated from the Plan. On the contrary, in principle and by obvious implication it has tolerated those very features and has in practical effect suggested that the Commission embody them in a new plan. The conclusive and inescapable basis of our objection is found explicit in the present record. It rests on facts found and reported by the Commission.

Basis of jurisdiction

The basis of jurisdiction of this court is Section 240 (a) of the Judicial Code (28 USCA Sec. 347) providing that in any case in a Circuit Court of Appeals it shall be competent for the Supreme Court of the United States to require by certiorari that the case be certified to it for determination.

Questions presented

1. Whether, on a railway reorganization under Sec. 77 of the Bankruptcy Act, an underlying mortgage fully secured by property the value of which is found to be far in excess of the amount of the mortgage, and whose interest has been and is being more than earned, may lawfully be discharged by the issue to its bondholders of reorganization securities of the following character:

a. First mortgage fixed interest bonds to the extent of 25 per cent of the face value of the old bonds and unpaid interest, secured by the mortgage of a railway corporation obliged by its charter to operate an entire railway system including not only the original mortgaged line but an extensive addition thereto never covered by the underlying mortgage, of which addition it is found that no earning capacity exists and whose operation at a loss would be a serious and permanent burden on the reorganized company.

b. Contingent interest second mortgage bonds of such enlarged railway corporation to the extent of 55 per cent of the face value of the old bonds and unpaid interest, such contingent interest bonds being part of an issue which includes a substantial amount of bonds given to the holders of bonds under a mortgage junior and subordinate, so far as the main line is concerned, to the underlying mortgage first mentioned, where no compensation is awarded the holders of the underlying bonds for the dilution of their existing lien by the inclusion of such new bonds issued to holders of such junior bonds; and

c. Preferred stock in such enlarged railway corporation for the remaining 20 per cent of the face value of the underlying bonds and unpaid interest; such amount of preferred stock representing but a small portion of the entire issue, the greater part of such issue being given to holders of securities junior to that of the underling mortgage, and no compensation being awarded the holders of the underlying bonds for such dilution of their existing lien.

2. On a railway reorganization under Section 77 of the Bankruptcy Act, when the minimum prospective earnings available for fixed charges shall have been deter-

mined, whether on capitalizing the same for reorganization securities there may be deducted therefrom a substantial proportion thereof to provide an annual fund for additions and betterments of a capital nature and the amount of fixed interest mortgage bonds to be awarded the underlying mortgage bondholders correspondingly reduced.

3. In the event that after the lapse of more than four years since the closing of evidence by the Interstate Commerce Commission in a reorganization proceeding under Section 77 of the Bankruptcy Act, the order of the District Court approving the Plan is reversed and the case remanded to the Commission with directions to make necessary findings, any of the parties to the proceeding may lawfully be deprived of their right to present to the Commission evidence in respect to the earnings and value of the mortgaged property subsequent to the period available when the former Plan was prepared, and whether the reception of such evidence may be lawfully left to the discretion or determination of the Commission.

Reasons relied on for the allowance of the writ

1. Practical need of present determination by court of last resort

It would be unfortunate to send the case back to the Interstate Commerce Commission, as the order of the Circuit Court of Appeals provides, with grave questions of law left so largely hanging in the air; thence to pass again through the slow process of the Commission, the District Court and the Circuit Court of Appeals and at that late date only to bring the case to this court, should this court so decree, for the belated determination of the fundamental questions basic to the making of a plan which will conform to law. The determination of those prin-

ciples by the court of last resort should rather be available as the norm or standard of reference in the final formulation of the plan. It is to the public interest that we have the judgment of this court on the fundamental questions involved. In a judgment now rendered by this court finality will be implicit.

2. THE PRINCIPLE OF ABSOLUTE PRIORITY OF LIEN. DILUTION OF MORTGAGE LIENS WITHOUT COMPENSATION

The Circuit Court of Appeals has decided in this case several important questions of federal law, herein specified, in a way palpably in conflict with applicable decisions of this court. The principle of absolute priority declared in *Northern Pacific R. R. Co.* v. *Boyd* (228 U. S. 482) definitely establishes that existing priorities may not be subverted in reorganization. This principle, applied in the *Boyd* case to an equity receivership, has by more recent decisions of this court in *Case* v. *Los Angeles Lumber Co.* (308 U. S. 106) and *Consolidated Rock Products Co.* v. *Du Bois* (312 U. S. 540) been declared equally applicable to reorganizations under the Bankruptcy Act. Under these decisions of this court it is the law of the land that holders of underlying bonds are entitled to the preservation, on reorganizations in bankruptcy, of their priority of lien or to the award of full compensation where it may be impracticable to preserve such lien in its existing form. The Circuit Court of Appeals has of course not in terms declared that the principle of absolute priority is not applicable to railway reorganizations, but the effect of its present decision is to put the General Mortgage bondholders of the Milwaukee outside the protection of that principle. The Series A and B of new income bonds, of which Series B are to be shared with junior lienors, and a minority block of preferred stock, are the new securities offered them for 75 per cent of their claim under their present underlying bonds. These, along with the new first

mortgage bonds for the other 25 per cent of their claim, make the whole of what they are to receive for their underlying lien. As this is all they get, it is mathematically impossible that compensation can be found in the Plan for the sacrifice of their first lien position.

Thus to scale down the rights represented by existing priority of lien, distributing at the same time other securities among junior lienors while leaving the underlying bondholders' sacrifice of lien uncompensated, is to fly in the face of the principle of absolute priority so repeatedly and emphatically pronounced by this court. As this court said in *Consolidated Rock Products Co.* v. *Du Bois* (312 U. S. 510, 528-9):

> "Thus it is plain that while creditors may be given inferior grades of securities, their 'superior rights' must be recognized. Clearly, those prior rights are not recognized, in cases where stockholders are participating in the plan, if creditors are given only a face amount of inferior securities equal to the face amount of their claims. They must receive, in addition, compensation for the senior rights which they are to surrender. If they receive less than that full compensatory treatment, some of their property rights will be appropriated for the benefit of stockholders without compensation. That is not permissible. The plan then comes within judicial denunciation because it does not recognize the creditors' 'equitable right to be preferred to stockholders against the full value of all property belonging to the debtor corporation'. Kansas City Terminal Ry. Co. *v.* Central Union Trust Co., supra, 271 U. S. page 454, 46 S. Ct., page 551, 70 L. Ed. 1028."

The junior lienors with which the General Mortgage bondholders are thus forced to share are the bondholders under the Fifty-Year mortgage, whose primary lien is on the so-called lines west, the unprofitable Pacific extension whose construction and continued deficits are primarily responsible for the road finding itself today in a bank-

ruptcy court. Of this ill-advised enterprise the Commission has found that "on any reasonable allocation between the lines west and the other parts of the system the lines west cannot be expected to earn any sum for the payment of interest" (1307-8). The Fifty-Year mortgage is a junior lien on the main line on which our mortgage is an underlying lien. Its bondholders are entitled to a first lien on their Pacific extension and a lien on our main line subject to our first lien thereon. Their rights may not be exalted to a right to cut down our prior lien unless full compensation be afforded us, and of such compensation there is no suggestion. Therefore the order of the Circuit Court of Appeals should have corrected this manifest violation of the mandate imposed by the statute.

This presents a question of law of the utmost general importance in railway reorganization. We have the not uncommon situation of a remunerative main line forced into a bankruptcy court through the ill fortunes of an enterprise taken on long after the underlying bonds had been put out. The new securities to be allotted the bondholders of such unprofitable extension may not lawfully be of the same rank as those given the underlying bondholders having a prior lien unless full compensation be made to the latter for such impairment by dilution of their lien. The attempt to accomplish such dilution renders the present Plan confiscatory and subjects it to the condemnation of the *Los Angeles Lumber Company* and *Consolidated Rock Products* cases. Its importance is evidenced by the number of pending reorganizations in which a similar situation is presented. If it be true that the nature of a railway investment is so profoundly different from that of a mortgage generally, as developed and established through a long history of judicial exposition, that considerations of public interest justify such a subversion of its lien and subjection to the risks of new enterprises not owned or conceived of when the mortgage was given, then

the investing public should be made authoritatively aware of the altered and novel place of their security before the law. These issues are here concretely presented. They should be decided by the court of last resort.

3. Additions and betterments fund

The Circuit Court of Appeals has decided an important question of federal law which has not been, but should be, settled by this court. It categorically approves in principle the Plan's device of an "Additions and Betterments Fund," a fund for capital expenditures to be withdrawn from the income, its amount fixed mandatorily at $2,500,000 per year, thus reducing the permissible fixed interest capitalization by the capitalized value of $2,500,000. At the adopted interest rate of 4 per cent this means $62,500,000. The result is that the holders of the underlying bonds find allotted them $62,500,000 less of fixed interest bonds than they would have received but for the interposition of this $2,500,000 Additions and Betterments Fund.

Capital funds of this kind, appropriated out of the net income already pledged to mortgage bondholders for the payment of their interest, have been coming much into fashion among current proposed plans of reorganization, but have not yet been considered by this court. Of course the effect of such a Plan is to make use of net income to enrich and fortify the physical assets of the enterprise while the bondholders must, to that extent, go without their fixed interest, trusting to find it, if the earnings continue high enough, somewhere farther down the line. Additions and betterments are not a new category in railway financing. They inherently are and always have been considered a capital charge, quite distinct from maintenance, and they have always appeared in the capital account. The principle or guiding concept of the present

fashion is precisely the same as that which would be applied if a farmer who had mortgaged his farm, specifically pledging its net income, were to announce that his farm would be improved by the construction of a silo and that he had decided to use the net income of the farm to build a silo instead of to pay the mortgage interest, and such a modification of the mortgage were to receive judicial sanction.

Whether such a diversion of net income may lawfully be mandatorily imposed on a railroad with the immediate, simultaneous and necessary consequence of cutting down its fixed interest mortgage obligations is to say the least a novel question. Certainly the principle has never been announced by this court, and it presents a question that emphatically ought to be settled by this court. The decision below asserts that such diversion of income and subversion *pro tanto* of mortgage lien is quite legal. Indeed the court declares (2313) that "In fact we find few things in the Plan which appeal stronger than this provision," but this is all it has to say about its legality. Of that there is not a word of discussion or exposition.

The problem of providing for additions and betterments without unlawful destruction of liens whose right to the maintenance of their absolute priority has received the repeated sanction of this court is of course a difficult one. We are confronted by the inescapable fact that a railroad must have additions and betterments and that the financial sources of outside capital traditionally available therefor are not so plentiful as they have been. The Plan, however, provides for an open first mortgage, the first series of which is of such small amount that it seems unduly pessimistic to regard the sale of bonds under other series as wholly excluded. The diversion of pledged income to capital additions and betterments runs counter to the respective decisions of this court as cited above. If on some theory to be now established this may lawfully be

built into a plan of reorganization at all, it can be nothing other than a forced loan. If that could be done, the displaced bondholders must receive at the very least contingent interest bonds whose interest, if thereafter earned, may repay the loan thus forced from them. This vital question of additions and betterments to enrich the equity at the expense of secured bondholders is most emphatically one on which this court should at the earliest opportunity, afforded by a concrete case such as the present, announce the legal principle to be observed in such cases.

For many years under the Commission's accounting rules it has been necessary to charge additions and betterments to capital account and to finance them either from earnings or by the issue of new securities. In no event has it been possible to resort to what is proposed here—the illegal device of taking income already pledged to the payment of mortgage interest and diverting it to the cost of capital improvements. Certainly on this whole question of provision for additions and betterments it is of the highest public interest that this court state clearly and unequivocally the principle applicable to such a situation. Otherwise the prevalent intrusions into the income account of additions and betterments funds will cast an ominous shadow on the whole field of future railway investment. In short, this issue presents an important question of law which has not been, but should be, settled by this court.

4. Forcing a reorganized road to carry an unremunerative enterprise

Another question which should be settled by this court is whether the holders of underlying railway mortgage bonds may lawfully be compelled to accept therefor mortgage bonds of a new company owning and by its charter bound to operate a railway line altogether separate and distinct from the line originally mortgaged, the two lines being united only at their point of meeting, where the new line is found by the Commission to be without earning capacity. The facts showing the lack of earning capacity in the lines west were specifically found and reported by the Commission. We contend that to force on our bondholders in perpetuity the burden of paying the deficit of a road not within their mortgage is illegal. What was and is obviously called for is a separate first mortgage on the lines west, giving their present bondholders a second mortgage on our main line, corresponding with their present second lien, and a first lien on any assets on which they now have a first lien, subject to whatever adjustments may be equitably demanded by way of subrogation or marshaling.

Similar situations have arisen before, where a railway has been condemned to disaster by the ill-advised taking on of new construction not warranted by the country's needs. So long as the united enterprises as a whole could pay its way, no judicial relief was necessary. But when the point was reached where the deficit adjunct was carrying the whole enterprise to insolvency, the senior mortgagee might rely on the security given by his mortgage lien. It was that fundamental right that made it possible to finance railways by the sale of bonds. The Circuit Court of Appeals' acquiescence in the principle of the present Plan as fair and lawful presents an issue of the greatest import to all who would invest in railway bonds. It

is of the utmost interest that the question be settled by the court of last resort. It is hard to imagine a case more clearly within the range of the established policy of this court of giving ear and rendering judgment when such grave issues stand waiting the word of finality.

5. On a rehearing by the Commission the right of all interests to be heard and to present evidence should be preserved

We think that the provision in the order sought to be reviewed whereby it is left to the discretion of the Commission whether or not it will receive further evidence presents an important question of federal law that has not been and should be settled by this court. To meet the plain requirements of the law any plan must be cleared of the legal defects which vitiate the present Plan. What is imperatively needed at this point is a clear statement by this court of the fundamental principles necessary to be claimed. As the present order reads, the Commission would find, in the language of the opinion below, that the case has been remanded "for the making of findings and, *if necessary,* the taking of additional evidence" (2317; italics ours). We can hardly consider that the Commission would seriously attempt to make findings leading to a reorganization having the enduring consequences here involved, without making available to itself the history and actual fortunes of the road since the time when its present record closed some four years ago. Too much water has flowed over the dam since that time to make an estimate of earning capacity based on data ending with 1937 the proper basis of a plan made in 1942. What might be considered adequate then would not be so now. The statute itself imposes the mandate that due consideration be given to "*present* earnings." Yet as the order stands the Commission may apparently receive or not re-

ceive new evidence, according as it may or may not "deem it necessary." Indeed, in a supplemental order issued, to use the language of the court, to make its position clear, the Circuit Court declares that the new inquiry need not extend to the value of the equity of the Debtor evidenced by the common and preferred stock, and that the Commission may, "although it is not required to do so, reexamine the evidence, or receive additional evidence, if in its judgment, justice to the parties requires it" (2335). We believe that it would be setting an unfortunate precedent for a railway reorganization to be sent back to the Commission to make findings with a suggestion of possible judicial approval that the door may at the Commission's discretion be closed to evidence of the operation and history of the road brought fairly down to date. The statute requires a consideration of past, present and prospective earnings, and if the Commission were to attempt to make new findings based only on the earnings reflected in the present report and Plan, it would be wholly excluding from consideration present earnings and indeed a substantial part of past earnings. In view of the approaching consummation of this and other reorganizations of major railway systems, such an important question running to the very heart of administrative and judicial investigation should be settled by this court.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari issue from this court to review the judgment or order of the United States Circuit Court of Appeals for the Seventh Circuit, entered herein December 4, 1941, reversing the order of the District Court for the Northern District of Illinois which approved the Plan of Reorganization of the above named Debtor certified by the Interstate Commerce Commission, as modified by such Commission, which order of the Circuit Court of Appeals further directed the District Court to set aside its order

of approval and to remand the case to the Interstate Commerce Commission, and your petitioner prays that on such review the order of the Circuit Court of Appeals be modified as specified in this petition.

March 23, 1942.

GEORGE L. SHEARER,
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Attorneys for petitioner.

(37)

IN THE

Supreme Court of the United States

51

October Term, 1941 Docket No. 882 ~~1083~~
C. C. A. No. 7616

In the Matter of

CHICAGO, MILWAUKEE, ST. PAUL & PACIFIC RAILROAD COMPANY, DEBTOR

TRUSTEES OF PRINCETON UNIVERSITY, ET AL., constituting the "UNIVERSITY GROUP" of General Mortgage Bondholders of CHICAGO, MILWAUKEE & ST. PAUL RAILWAY COMPANY

Petitioners

against

GROUP OF INSTITUTIONAL INVESTORS, ET AL.

Respondents

CROSS-PETITION FOR WRIT OF CERTIORARI AND BRIEF IN SUPPORT OF PETITION

FREDERICK J. MOSES
Attorney for Trustees of Princeton University et al., constituting the "University Group" of General Mortgage Bondholders of Chicago, Milwaukee & St. Paul Railway Company
70 Pine Street
New York City

March 20, 1942

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IN THE

Supreme Court of the United States

October Term, 1941 **Docket No. 882**

In the Matter of

CHICAGO, MILWAUKEE, ST. PAUL & PACIFIC RAILROAD COMPANY, Debtor.

TRUSTEES OF PRINCETON UNIVERSITY, *et al.*, constituting the "UNIVERSITY GROUP" of General Mortgage Bondholders of CHICAGO, MILWAUKEE & ST. PAUL RAILWAY COMPANY,

Petitioners,

against

GROUP OF INSTITUTIONAL INVESTORS, *et al.*, *Respondents.*

C. C. A. No. 7616

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioners are a group [1] of owners and holders of General Mortgage bonds of the Chicago, Milwaukee & St. Paul Railway Company, the predecessor of the Debtor.

[1] This Group was formed to assert and protect the rights of the General Mortgage Bondholders, in the Summer of 1940 when it became apparent that the Institutional and Savings Banks Groups, which had asserted those rights before the Commission, would acquiesce in the Commission's Plan of Reorganization. The members of the Group and their holdings of General Mortgage Bonds are:

The Trustees of Princeton University	$100,000
New York University	25,000
Milbank Memorial Fund	200,000
Bank for Savings of the City of New York	1,100,000
Union Square Savings Bank, New York City	550,000
Greenwich Savings Bank, New York City	179,000

(*Footnote continued on page 2*)

The Group of Institutional Investors and Mutual Savings Banks Group have heretofore, and on or about January 17, 1942, filed the record and a petition for a writ of certiorari to review the judgments of the United States Circuit Court of Appeals for the Seventh Circuit, entered in this cause on December 4, 1941, which reversed the order of the United States District Court for the Northern District of Illinois (which order approved a plan of reorganization for the Debtor, certified by the Interstate Commerce Commission), and remanded the proceedings to the Interstate Commerce Commission with directions that it make findings of fact as to values and other matters, "as indicated in the opinion" of that Court, thereby making the opinion a part of the judgment. In its opinion (R. 2312) the Court adjudged that "the fact situation permits of a plan such as the Commission formulated and approved. The Plan as such, ignoring the absence of findings, has support in the evidence. It violates no requirements (save findings) announced in the *Consolidated Rock Products* case" (312 U. S. 510).

(*Continuation of footnote from page* 1)

Bank of New York, as Trustee	130,000
New York Trust Company, as Trustee	70,000
U. S. Trust Company of New York, as Trustee for Individual Beneficiaries	481,000
Boston Insurance Company	75,000
Old Colony Insurance Company of Boston	30,000
New Amsterdam Casualty Co. of New York	176,000
First National Bank of Everett, Washington	25,000
Consolidated Investment Trust, Boston	400,000
Robert Winthrop, as Trustee and Guardian	296,000
Edgar Palmer, as Trustee	100,000
E. Sohier Welch and George E. Brown, as Trustees, Boston, Massachusetts	35,000
Grenville L. Winthrop, New York City	110,000
Wood, Struthers & Company, New York City	300,000
Charles M. Wood, Philadelphia, Pa.	247,000
Leo Wallerstein, New York City	50,000
Beekman Winthrop, Individually and as Trustee (now deceased) was a member	273,000

We do not oppose the Groups' petition and we file this Cross-Petition, believing it to be important that this Court now determine the questions of law arising out of Section 77 of the Bankruptcy Act (enacted in 1933) so that the lower courts and the Interstate Commerce Commission may terminate this and other proceedings for the reorganization of railroads, without unnecessary delay.

The petition of the Institutional and Savings Banks Groups raises only the question whether or not the Circuit Court of Appeals erred in holding findings of facts and values to be essential and in directing that they be made.

The proceeding involved, and the Circuit Court of Appeals decided a number of other important questions of Federal law (hereinafter stated) which have not been but should be settled by this Court, the final determination of which questions of law is important, not only in this cause but also in other proceedings for the reorganization of railroads. Some of those questions have been decided in a way, probably in conflict with applicable decisions of this Court.

Jurisdiction

The judgments of the Circuit Court of Appeals were entered on December 4, 1941 (R. 2318-2324). The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (28 U. S. C. A. Sec. 347).

Statutes Involved

The issues involve the construction of Section 77 of the Bankruptcy Act (11 U. S. C. A. 205) and its application to the facts of this case. The most pertinent provisions of that statute are reproduced as an appendix, *infra*, p. 31.

Opinions Below

The reports and orders of the Interstate Commerce Commission are reported at 239 I. C. C. 485 and 240 I. C. C. 257 (Original Report, R. 2153-2269, and Order R. 1258-1283; Supplemental Report, R. 1284-1317, and Supplemental Order, R. 1319-1347). The opinion of the District Court (R. 1857-1899) is in 36 F. Supp. 193. The opinion of the Circuit Court of Appeals (R. 2297-2317, 2334-35) has not yet been reported.

Statement of Matters Involved

The General Mortgage, made by the predecessor of the Debtor in 1889 (securing $150,000,000 of which $138,788,000 are outstanding in the hands of the public [R. 2269]), is a first lien on some 6,000 miles of railroad of which the elements of physical value, as appraised by the Interstate Commerce Commission for rate making purposes, are about $359,000,000 (R. 2215) and rolling stock, worth after depreciation about $49,000,000 over and above equipment liens on a part thereof, as of June 30, 1935.

In 1936, the only year as to which studies segregating the earnings of the several mortgage divisions were in evidence before the Interstate Commerce Commission, which earnings studies were accepted by the Interstate Commerce Commission and made the "basis" (R. 2251) of its plan, the 6,000 miles of General Mortgage Lines produced over 88 per cent. of the income available for fixed charges of the entire system of about 11,000 miles (Exh. 181, R. 723).

The annual interest on the General Mortgage bonds outstanding is about $6,000,000. The Commission's Report states that the earnings of the General Mortgage Lines for 1936 were $8,716,847, or $7,561,688 after deducting interest

on equipment obligations (R. 2250). It was proved before the District Court that during the first 3½ years of operation by the Trustees in Bankruptcy, from July 1, 1935 to December 31, 1938, the earnings of the General Mortgage Lines available for the payment of interest, were $26,817,802, or about $6,000,000 more than the bond interest accrued during that period (R. 220). The earnings of the System available for fixed charges for 1939 were nearly $10,000,000; for 1940, nearly $15,000,000 and for 1941 nearly $30,000,000.

There is in the record no finding, and no basis for a finding, that the General Mortgage bonds are not fully secured.

The Milwaukee & Northern and the General Mortgage Lines were the only Lines which were operated at a profit (Exh. 181, R. 723).

Regarding the "Lines West" (some 2860 miles of railroad extending from the Missouri River to the Pacific Coast), the Commission reported "We are satisfied that on any reasonable basis of allocation between the Lines West and the other parts of the System, the Lines West cannot be expected to earn any sum for the payment of interest" (R. 1307-8). This finding is confirmed by proof before the District Court that during the first 3½ years of operation by the Trustees in Bankruptcy, the "Lines West" had an operating deficit of $5,392,544 (R. 1780-81).

The Commission found the probable future earnings of the System available for the payment of fixed charges to be $7,859,106 (R. 2190), "considered to be a minimum" (R. 2219). This represents the Commission's estimate of what will be left of the future earnings of the General Mortgage and Milwaukee & Northern Lines after deducting the operating deficits of the other mortgage divisions. Of this $7,859,106 the Commission allocated to the General Mortgage bondholders only $1,563,682 (less than 1/5 of that $7,859,106) in fixed interest (R. 1317).

It was proved before the District Court that the Milwaukee and Northern Consolidated Lines have become permanently deficit lines (Court Exhs. 28, 29, 30, R. 1723, 1746-8).

The Plan discriminates against the General Mortgage Bondholders

Excepting the equipment liens which are undisturbed and undisturbable (§ 77 (j) of the Bankruptcy Act), there are only three classes of fully secured creditors. The Reconstruction Finance Corporation collateral loan of about $12,000,000; the Milwaukee & Northern First Mortgage $2,117,000 and the General Mortgage $150,000,000, of which a little less than $139,000,000 are outstanding in the hands of the public.

The Plan awards to the Reconstruction Finance Corporation 100 per cent.; to the Milwaukee & Northern First Mortgage bonds 70 per cent. and to the General Mortgage bonds only 25 per cent. of the face of their claims in new First Mortgage Fixed Interest bonds.

The General Mortgage secures bonds at the rate of about $25,000 per mile of General Mortgage Lines. Under the Plan, these bondholders would receive new First Mortgage Fixed Interest bonds at the rate of about $6,500 per mile on the General Mortgage Lines saddled with the deficits of the other lines.

The four classes of Terre Haute bondholders have liens aggregating about $22,000,000 (R. 2169) on 360 miles of road, leased to the Milwaukee—about $65,000 per mile. Under the plan the 120 miles fram Latta to Westport, Indiana, one-third of the whole Terre Haute road (Ct. Ex. 15, R. 1685), is to be abandoned (R. 2236) as worthless (Ex. 77, R. 300) which will make the Terre Haute mortgage liens about $97,700 per mile. The physical elements of value of the Terre Haute amount to about $1,000,000 less than the mortgage liens (R. 2215).

In addition to their liens on the Terre Haute line, they have an *unsecured* claim (R. 1304, 2213) against the *bankrupt* Debtor on its guaranty of the principal and interest of the Terre Haute bonds under a lease which the Court below referred to as "malodorous" (R. 2305) and unethical (R. 2311 footnote). Nevertheless, the Plan provides that the *solvent* reorganized Milwaukee shall guarantee the principal and fixed interest on all the Terre Haute bonds. For good measure, the Plan increases from 4% to 4¼% the interest on one-third of those bonds (R. 2169) (the Southern Indiana Fours) which are a first lien on the one-third of the road which is to be abandoned.

The Plan deprives the General Mortgage Bondholders of their priority without compensation

The proposed new First Mortgage is to be a lien upon the whole System, including the deficit lines. The General Mortgage bondholders receive only 25% of their claim in new First Mortgage bonds. Without compensation to them, 75% of their claim is subordinated to the other First Mortgage bonds to be issued and to the fixed interest on the Terre Haute bonds, whose claim against the bankrupt Debtor is unsecured.

There has been no determination of the disputed question of what property is subject to each mortgage

The Commission (on the ground that it has not jurisdiction to determine questions of law [R. 1151]), the District Court and the Circuit Court of Appeals all declined to determine the disputed question whether or not the General Mortgage is a first lien upon 17 pieces of profitable road, aggregating 574.94 miles (R. 221-2), which are cut-offs, branches and connections between points on the General Mortgage Lines and which are referred to in the record as "Pieces of Lines East."

In the allocation of earnings for 1936, the earnings of these "Pieces of Lines East" were credited to the 50-Year 5% Mortgage and not to the General Mortgage (Ex. 181, R. 723). The Commission in its report states that the propriety of so including these earnings is doubtful (R. 2252).

The "Net Revenue from Railway Operation" of these "Pieces of Lines East" in 1936 was $1,456,800, more than 70 per cent. as large as the corresponding revenue of the 2860 miles of "Lines West". After deducting taxes, etc., the "Total Income Available for Fixed Charges" of the "Pieces of Lines East" was $170,100 and of the "Lines West", a deficit of $1,108,535 (Ex. 181, R. 723).

The Plan diverts earnings available for fixed charges to Capital Investments

The Commission found the probable future earnings of the System annually available for fixed charges to be $7,859,106 and deducted enough to make the "coverage" about 1.16 leaving $6,759,654. Instead of applying the earnings available for fixed charges to the payment of fixed charges, as required by the statute § 77(b)(4) they have provided that $2,500,000 thereof shall be diverted to capital expenditures for the benefit of junior creditors who will become stockholders under the new Plan. The effect of this provision is to reduce the First Mortgage bonds issuable to the General and Milwaukee & Northern bondholders by $62,500,000, and during the 50-year life of the new First Mortgage to take away from the General Mortgage bondholders nearly $125,000,000 to which they are entitled as interest.

The Plan does not recognize the right of subrogation

The Commission has found that the only mortgage lienors entitled to receive new First Mortgage Fixed Interest bonds are the General and Milwaukee & Northern Mortgages.

Instead of permitting the Reconstruction Finance Corporation to satisfy its claim out of the collateral security for its note, the Plan provides that the R. F. C. shall receive 100 per cent. of its claim in new First Mortgage Fixed Interest bonds, thereby reducing the number of such bonds distributable to the General and the Northern bondholders. Instead of subrogating the latter, at whose expense the debt to the R. F. C. is to be paid, to the rights of the R. F. C. in that collateral, the collateral is treated under the Plan as being subject to the lien of the 50-Year 5% Mortgage. This collateral and the "Pieces of Lines East" are the only assets, having any value, on which the 50-Year Mortgage can claim a prior lien.

The Plan gives to the General Mortgage Bondholders no compensation for the surrender of their senior rights and priority

The Plan awards to the General Mortgage bondholders only "the face amount of inferior securities equal to the face amount of their claims," namely, 25% of their claim in new First Mortgage Fixed Interest bonds; 35% in Second Mortgage Income bonds, upon which interest can be paid only if earned over and above the First Mortgage interest and the $2,500,000 capital fund for Additions and Betterments; 20% in Second Mortgage Series B Income bonds, upon which the interest can be paid only after the foregoing and (in the discretion of the directors of the Railroad who will represent the stockholders) after the payment of an additional $2,500,000 annually into the capital fund for Additions and Betterments; and 20% in the Preferred Stock of the reorganized company.

The junior and inferior 50-Year 5% bonds receive a part of the Series B Income bonds and are thus placed on a parity with 20% of our claim and are given priority over the 20% of our claim for which we are to receive Preferred Stock.

The old preferred stock was found to be worthless because it would require earnings of about $29,000,000 to pay its dividends. It has been computed that under the present tax law it would require nearly $44,000,000 earnings to pay the dividends on the new Preferred Stock.

The Milwaukee never earned as much as $33,000,000 in any year (R. 2180).

The court below held that the Commission "is not required" to receive additional evidence

The judgment of the Circuit Court of Appeals decreed that the order of the District Court be reversed "and that this cause be and it is hereby remanded to the said District Court with directions * * * to remand the case to the Interstate Commerce Commission for the making of findings and, *if necessary, the taking of additional evidence* that additional findings may be made *as indicated in the opinion of this Court filed herein*" (R. 2323) thereby making the opinion a part of the judgment of the Court and a mandate to the Interstate Commerce Commission. (Italics ours.)

Thereafter, on a motion to modify the opinion, the Circuit Court of Appeals handed down an opinion, *per curiam,* in which the final sentence reads, "In other words, the I. C. C. has jurisdiction of the matter and *may, although it is not required to do so, re-examine the evidence, or receive additional evidence,* if in its judgment, justice to the parties requires it" (R. 2335). (Italics ours.)

Questions Presented

1. Whether or not a plan of reorganization which gives to one class of fully secured creditors less favorable treatment than is accorded to other fully secured or unsecured creditors be discriminatory?

2. Whether or not senior creditors may lawfully be deprived of their priority by allocating to them, without compensation, 75% of their claim in junior and subordinate bonds and stock?

3. Whether or not it be essential to the determination of the fairness of an allocation of securities among *railroad* mortgage bondholders, that there be a determination of what property is subject to each mortgage? (This Court held in the *Consolidated Rock Products* case that the failure to determine what property is subject to each mortgage is "fatal" to a plan of reorganization of a *business* corporation.)

4. Whether or not, when the Commission has found (as provided in Sec. 77 (b) (4) of the Bankruptcy Act) what are the probable future earnings available for the payment of fixed charges, after deducting adequate coverage, there be any authority under the statute to divert to capital expenditures any part of the earnings so found to be available for the payment of fixed charges?

5. Whether or not in a railroad reorganization proceeding under Section 77 of the Bankruptcy Law, creditors, at whose expense the claim of a secured creditor is to be paid under the Plan, be entitled to be subrogated to the rights of that secured creditor in the collateral held by it as security for its claim?

6. Whether or not when junior lienors and creditors are participating in a plan for the reorganization of a *railroad,* the prior rights of senior creditors be recognized if they be given only the face amount of inferior securities equal to the face amount of their claims?

7. Whether in a railroad reorganization under Section 77 of the Bankruptcy Act creditors whose claims are secured by mortgage on valuable revenue producing railroad lines can be required to accept bonds secured by a mortgage on those lines combined with other lines operated at a deficit which will consume a substantial part of the earnings of the lines which now secure their claims?

8. Whether or not it be fair, equitable and lawful under the guise of reducing the debt of a railroad corporation, to allocate to secured creditors preferred stock instead of income bonds, with the result that the reorganized company cannot, because of taxation, pay dividends on such preferred stock unless it shall earn many times the probable future earnings as ascertained by the Commission?

9. Whether or not it be, as a matter of law, the duty of the Interstate Commerce Commission, when a proceeding under Section 77 of the Bankruptcy Act be remanded to it, to receive additional evidence of changed conditions affecting the value and the earning capacity of the Debtor, its several mortgage divisions and its leased line, including the evidence received before the District Court, or whether it be lawful, after a lapse of four years, for the Commission, in its discretion, to refuse to receive and consider such evidence and to base its findings and its new plan of reorganization solely on the evidence which was before it when its hearing of evidence closed?

Reasons Relied on for the Allowance of the Writ

The opinion of the Court below having been incorporated in its judgment, the Interstate Commerce Commission will obey the mandate of that opinion in the formulation of a new report and plan.

That Court therein has decided important questions of federal law which have not been, but should be settled by this Court, some of which questions have been decided in a way probably in conflict with applicable decisions of this Court.

If the Circuit Court of Appeals be in error in the determination of any of the foregoing questions the proceeding would have to be remanded to the Interstate Commerce Commission a third time. Meanwhile, other railroad reorganization proceedings are pending, both before the Commission and in the District Courts, in which some or all of these questions have arisen, or will arise. We believe it to be important that the law governing railroad reorganizations, under Section 77 of the Bankruptcy Act, be settled as soon as may be, not only in order that this proceeding may reach an early final determination but also that the Interstate Commerce Commission and the lower Courts may apply the proper rules of law to other reorganization proceedings.

WHEREFORE, your petitioners respectfully pray that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the Circuit Court of Appeals for the Seventh Circuit, commanding that Court to certify and send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all of the proceedings in the cases numbered on its docket Nos. 7590, 7610-7617, and especially No. 7616, the appeal of The Trustees of

Princeton University, and others, constituting the "University Group" of General Mortgage Bondholders of Chicago, Milwaukee & St. Paul Railway Company, and entitled,

"In the Matter of Chicago, Milwaukee, St. Paul and Pacific Railroad Company, Debtor; Trustees of Princeton University, *et al.*, Constituting the 'University Group' of General Mortgage Bondholders of Chicago, Milwaukee & St. Paul Railway Company, *vs.* Group of Institutional Investors, etc., *et al.*, Appellees (And Consolidated Appeals)," and that the judgment of the Circuit Court of Appeals for the Seventh Circuit may be modified as to the matters set forth in this Cross-Petition; and they further

Respectfully pray that this cause be advanced for hearing out of its regular order, to come up at or about the same time with the cause of *The Western Pacific Railroad Company,* which cause presents some but not all of the questions herein propounded, and that your petitioners may have such other and further relief in the premises as to this Court may seem proper.

FREDERICK J. MOSES,
Attorney for Trustees of Princeton University, et al., constituting the "University Group" of General Mortgage Bondholders of Chicago, Milwaukee & St. Paul Railway Company.